BLAU, J.

IN THE

Supreme Court of the United States

October Term, 1961.

No. 66.

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

Petitioner,

against

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a copartnership, doing business under the firm name and style of LEHMAN BROTHERS, JOSEPH A. THOMAS and TIDE WATER ASSOCIATED OIL COMPANY,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S BRIEF.

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THE REPORTER COMPANY, INC., NEW YORK 7, N. Y.—REctor 2-6978—1961

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Opinions Below.

The majority and dissenting opinions of the Court of Appeals are reported in 286 F. 2d 786 (R. 174-192; 199-203). The opinion of the District Court (R. 149a-157a) is reported in 173 F. Supp. 590.

Jurisdiction.

The judgment of the Court of Appeals was entered on December 20, 1960 (R. 193). The order of the Court of Appeals which denied the petition for rehearing *in banc* (two judges dissenting) was entered on February 21, 1961 (R. 199, 204-205).

The jurisdiction of this Court rests upon 28 U. S. C. Section 1254(1) which is made applicable by Section 27 of the Securities Exchange Act of 1934 (15 U. S. C. Sect. 78aa). The petition for a writ of certiorari was filed on March 14, 1961 and was granted April 24, 1961 (81 S. Ct. 1048; R. 205).

The Statute and Regulation Involved.

Pertinent provisions of the Securities Exchange Act of 1934, Sections 16(a), 16(b) and 3a(13), 15 U. S. C. A. Sects. 78p(a), 78p(b) and 78c(a) (13), pp. 419, 362, are set forth in the Appendix, *infra*, pp. 51-52. Pertinent provisions of the Securities and Exchange Commission Rule X-16A-3(b), as amended October 4, 1952, 17 CFR 240. 16a-3(b), p. 149, Cum. Supp., are set forth in the Appendix, *infra*, p. 53.

Questions Presented for Review.

1. Under Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A. Sect. 78p(b), where one of the members of a co-partnership firm is a director of a corporation having equity securities listed upon a National Securities Exchange, is the *co-partnership* liable to such corporation for the "short-swing" profits realized by the firm from its purchases and sales of the corporation's equity securities within a period of less than six months?

2. Under Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A. Sect. 78p(b), where one of the members of a co-partnership is a director of a corporation having equity securities listed upon a National Securities Exchange, to what extent is such *partner-director* liable to the corporation for "short-swing" profits realized by his co-partnership firm as a result of its purchases and sales of the corporation's equity securities within a period of less than six months?

3. Under Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A. Sect. 78p(b), when a corporation is granted a judgment against an "insider" for the recovery of "short-swing" profits realized by him as a result of his purchases and sales of the corporation's equity securities within a period of less than six months, is the corporation entitled to recover interest upon such profits from the date they were realized and recoverable under the statute?

Statement of Facts.

The action was instituted by petitioner, Isadore Blau, as stockholder of Tide Water Associated Oil Company (hereinafter referred to as "Tide Water"), pursuant to Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sect. 78p(b), to recover the profits real-

ized by respondent, Lehman Brothers, from its purchases and sales of Tide Water's listed securities within a period of less than six months (R. 4a-6a).

During the times complained of the individual respondents were general partners in the firm known as Lehman Brothers, and will be referred to collectively by such name. The respondent, Joseph A. Thomas, one of the firm's general partners, was at the same time also a director of Tide Water (R. 4a, 5a, 7a).

Lehman Brothers is in the investment banking business; it is also a member of various stock exchanges, and trades in securities for its own account. The individual partners of Lehman Brothers are directors of various industrial and banking corporations (R. 32a-33a).

One of the respondents, John Hertz, testified that he became a partner of Lehman Brothers in 1934 "to bring business" to that firm (R. 60a, 62a); shortly thereafter he "joined Tide Water (as a director) thinking it was going to be in the interest of Lehman Brothers" (R. 65a), and that his official connection with Tide Water "surely brought (the) Tide Water business to Lehman Brothers" (R. 62a).

Mr. Hertz further testified that shortly prior to his resignation as a director of Tide Water he had a discussion with his partner, Joseph A. Thomas, and "asked him whether he would like to go on the (Tide Water) Board." Upon receiving an affirmative answer, Mr. Hertz "spoke to the president of the Tide Water Company" and recommended that Mr. Thomas replace him as a director on its Board (R. 64a).

Mr. Hertz conceded that one of his reasons for recommending the appointment of Mr. Thomas as a director to the Tide Water Board was because he thought "it was going to be in the interest of Lehman Brothers" (R. 65a).

As a result of Mr. Hertz's recommendation, respondent, Joseph A. Thomas, was appointed to the Tide Water Board on August 5, 1954, the date Mr. Hertz's resignation therefrom became effective. Mr. Thomas has held that office since that time (R. 36a, 38a).

Upon the trial of the action petitioner made a full offer of proof to demonstrate that the appointment of Mr. Thomas to the Tide Water Board was in no sense fortuitous, but was the result of a well-defined, pre-conceived and calculated plan initiated and executed by respondent, Lehman Brothers, for the express purpose and design of furthering that firm's personal interests. The Court refused to allow such proof * (R. 27a-31a; 88a-98a).

Respondents testified that it is the usual custom and practice of Lehman Brothers, prior to undertaking any financing or other business deals for a corporation, to discuss the matter with the particular partner of Lehman Brothers who is a director of the corporation involved "because he knows more about it" and "would be cognizant of what is going on" (R. 50a, 78a-79a).

After respondent, Joseph A. Thomas, had become a director of Tide Water, respondent, Lehman Brothers, participated in a $50 million bond underwriting issue for Tide Water; Mr. Thomas was assigned by Lehman Brothers to represent its interests with respect to such financing (R. 42a, 76a-77a). Prior to that time, and while Mr. Hertz was a director of Tide Water, the respondent, Lehman Brothers, had on several occasions performed similar services for Tide Water and had received compensation therefor (R. 17a).

* The offer of proof consisted of petitioner's Notice to Admit and the respondents' answers thereto (R. 9a-21a), indicating a definitive plan by Lehman Brothers to perpetuate one or more of its partners upon the Boards of corporations with whom the firm was doing business. Pursuant to stipulation the respondents had reserved their rights to object to the relevancy and materiality of the items set forth in the Notice to Admit, and the Court sustained the respondents' objections thereto.

Respondent, John Hertz, testified that prior to his resignation as a director of Tide Water, "there were several discussions" among its Board members with respect to a plan for converting the Tide Water common shares into shares of $1.20 dividend preferred stock and "a lot of different plans of financing the new (Tide Water) refinery" (R. 65a). Mr. Hertz admitted that he discussed these plans with his partners at Lehman Brothers in "a gossiping way," and further admitted that "we (Lehman Brothers) tried to advise the president (of Tide Water) to the best of our ability" with respect thereto. In response to a pointed question as to whether any of his partners at Lehman Brothers had asked his opinion "of Tide Water's management or its prospects," Mr. Hertz testified that "I probably gossiped about it" (R. 66a-67a).

Respondent, Joseph A. Thomas, testified that after he had become a director of Tide Water, several of his partners at Lehman Brothers asked for his opinion concerning Tide Water's management and policies and that he had expressed his opinions "freely" and had "suggested from time to time that I thought Tide Water under the new management was an attractive investment." Mr. Thomas further testified that one of such partners with whom he had the most extensive discussions concerning these matters was William J. Hammerslough, *who subsequently authorized Lehman Brothers' purchases of Tide Water common shares of stock* (R. 54a-56a; 70a).

Respondent, William J. Hammerslough, testified that "Thomas spoke very highly of the management and prospects of Tide Water Oil Company" and "thought very highly of it" (R. 69a). Mr. Hammerslough further testified that, prior to the time he authorized Lehman Brothers to purchase the Tide Water common stock, he had discussed the advisability of such purchases with some of his partners and they all felt "that this preferred stock

into which the common was going to be exchanged * * * would be a very, very safe, good investment, and would be attractive once it was issued, to institutional investors throughout the country" (R. 71a).

In the early part of September, 1954, subsequent to his appointment as a director, the respondent, Joseph A. Thomas, learned from another Tide Water director that the corporation was seriously considering a plan to permit certain of its stockholders to convert any or all of their common shares into shares of a contemplated new issue of $1.20 dividend preferred stock (R. 46a).

On October 8, 1954, it was publicly announced that Tide Water's Board had approved a plan to create a $1.20 dividend preferred stock and that its shareholders, other than three corporate stockholders owning in the aggregate 53 per cent of its common stock, "would have an opportunity to surrender all or any part of their common shares in exchange for the new preferred on a share-for-share basis" provided such plan were approved by the Tide Water stockholders at a meeting on November 15, 1954 (Defts. Ex. B; R. 163a, 75a).

Between October 8, 1954 and November 15, 1954, respondent, Lehman Brothers, purchased for its own account 50,000 shares of Tide Water common stock (R. 43a-44a). At the time these purchases were being effected, respondent, Thomas, was informed by his partners that Lehman Brothers was acquiring this common stock for the specific purpose of converting them into shares of $1.20 Dividend preferred stock and then selling the preferred to institutional investors (R. 49a-50a).

On December 8, 1954, respondent, Lehman Brothers, converted the 50,000 shares of its Tide Water common

stock and received in exchange therefor 50,000 shares of Tide Water's newly created $1.20 dividend preferred stock (R. 86a). The district court properly ruled that such acquisition by Lehman Brothers of the Tide Water preferred stock constituted a "purchase" thereof within the meaning and intent of Sections 3(a) (13) and 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sects. 78c (a) (13) and 78p (b); and that Lehman Brothers' cost of such preferred shares was "the lowest price at which Tide Water common stock was selling on the conversion date," namely, "$25.25 per share" (R. 156a).

Between December 8, 1954 and March 8, 1955, respondent, Lehman Brothers, sold its 50,000 shares of Tide Water preferred stock for the net sum of $1,361,186.77 (R. 87a).

The District Court found, after trial without a jury, that respondent, Lehman Brothers, had realized "short-swing" profits aggregating the sum of $98,686.77 from its aforesaid transactions in the Tide Water preferred stock (R. 156a).

The Court dismissed the complaint as against respondent, Lehman Brothers, and entered judgment against respondent, Joseph A. Thomas, in the sum of only $3,893.41 which represented the latter's *proportionate partnership share* of the total "short-swing" profits realized by respondent, Lehman Brothers, as aforesaid. The Court also refused to allow any interest upon such recovery (R. 155a-156a, 158a).

The United States Court of Appeals for the Second Circuit affirmed the judgment of the District Court (R. 174, 193) with a strong dissenting opinion by Judge Clark (R. 186).

Petitioner's motion to certify questions to the United States Supreme Court (R. 198a) was denied by the Court of Appeals—Judge Clark dissenting (R. 203a).

The motion made by the Securities and Exchange Commission for leave to participate *amicus curiae* and to file a petition for rehearing (R. 194), was denied by the Court of Appeals—Judge Clark dissenting (R. 196). Petitioner's application for rehearing *in banc* (R. 197) was denied by the Court of Appeals (R. 199), with a dissenting opinion by Judge Clark with which Judge Smith concurred (R. 199).

Summary of Argument.

The stated Congressional purpose for the enactment of Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., 78p(b), was "preventing the unfair use of information which may have been obtained by such beneficial owner, director or officer by reason of his relationship to the issuer."

In attempting to foreclose the avenue of proven abuses to such "insiders" having access to corporate information not available to the general investing public, the method adopted by Congress to accomplish this result was to make the "insider" disgorge *all* the profits realized by him from his "short-swing" transactions in the issuer's securities "irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months."

In specifying three categories of those who clearly have access to inside corporate information, the Legislature at no time evinced any intention of limiting the statutory application to only those *literally* designated therein while completely exonerating others who demonstrably fall within its inhibitory ambit and similarly have access to and actually make use of inside information for their own selfish interests.

In construing Section 16(b) of the Act, the Courts have uniformly held the statute to be "broadly remedial"[1] and its purpose "to strike down *any means* by which insiders, because of their special knowledge of the affairs of the corporation or the plans of its board of directors, might realize for themselves a 'short-swing' profit, which would be denied the other stockholders or investing public, not enjoying such inside information."[2]

The close relationship between respondent, Thomas, and his partners, respondent, Lehman Brothers, was such as to constitute them collectively as "insiders" within the intent and meaning of the statute. The respondent, Lehman Brothers, acting as an entity, and having its firm interests represented upon Tide Water's Board by Mr. Thomas, had the same influence and access to confidential information as its partner who was at the same time a director of Tide Water. Indeed, the evidence in the record clearly indicates that such confidential information was actually imparted by Mr. Thomas to a number of his partners at Lehman Brothers and constituted the basis for that firm's subsequent purchases of Tide Water's common shares.

Although the legislative history and the statute itself indicates that Congress eliminated a "subjective standard of proof"[3] for applying the provisions of Section 16(b), the decision by the Court below in *Rattner v. Lehman* (C. A. 2), 193 F. 2d 564, which was followed in the case at bar, appears to make such "subjective proof" the criterion for any recovery against the partnership.

In view of the history and legislative purpose of Section 16(b), the courts have consistently applied an interpre-

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[1] *Smolowe v. Delendo Corp.*, 2 C. A., 136 F. 2d 231, 239.

[2] *Kogan v. Schulte*, 61 F. Supp. 604, 608; aff'd *sub. nom.; Park & Tilford, Inc., v. Schulte*, 2 C. A., 160 F. 2d 984.

[3] See *Smolowe v. Delendo Corp., supra*, p. 236; *Gratz v. Claughton* (C. A. 2), 187 F. 2d 46, 50, cert. denied, 341 U. S. 920.

tation to the statute in particular cases so as to fully effectuate the Congressional aims therefor. A notable exception to such uniform interpretation was made by the Second Circuit Court of Appeals in the instant case where, as Judge Clark noted, "the incentive to take insiders' profits is strongest as a part of a trading firm's normal business and where exception is the most difficult to understand" because of "the unfair discrimination it builds into an important remedial statute—a discrimination substantially eliminating the great Wall Street trading firms from the statute's operation."[4]

Although Judge Medina, writing the majority opinion for the Court below, recognized that the legislative purpose of the statute requires that it be construed "to include the partnership because of the unity of the partnership relationship and the fact that one of the partners is a director," he felt "bound" to follow the Court's earlier decision in the *Rattner* case, *supra.*

In the *Rattner* case, *supra,* as here, the Court below refused to impose any liability upon the partnership which had realized the short-swing profits, while limiting the recovery from the partner-director to the latter's partnership interest in his firm's profits. The rationale for the Court's decision in that case was predicated upon a *literal* interpretation of Section 16(b) rather than upon a *broad* construction which would effectuate its legislative purpose.

However, even under any *literal* interpretation of the statute, since each partner is the "co-owner" of all partnership property, the partner-director should have been held accountable under the statute for *all* of his firm's short-swing profits unless the legal meaning of "owner," as used in Section 16(a) of the Act, is construed to exclude a "co-owner."

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[4] *Blau v. Lehman* (C. A. 2), 286 F. 2d 786, 799; R. 187, 202, 203.

Although acknowledging that under the "broadly remedial" nature of Section 16(b), an interpretation requiring the partnership to pay back its short-swing profits would be "one way" to effectuate the legislative purpose of the statute, the Court below, nevertheless, refused to apply such construction, but, instead, chose to follow the *literal* statutory interpretation of its prior ruling in the *Rattner* case.

Turning to the partner-director, Thomas—the Court below found that since he had waived all rights to receive any part of his firm's short-swing profits, a *literal* application of the statute would obviously absolve him from any liability. Here too, as in the case of the partnership, the Court acknowledged that unless the provisions of Section 16(b) were applied to such partner-director, "we shall have opened a breach in the law through which stockbrokers and investment banking houses, those most likely to be in a position to profit by the use of confidential information in stock speculation, can pass with impunity."

Emphasizing that the legislative purpose of the statute required a construction which would impose liability upon the partner-director—although the same considerations were also present in the case of the partnership—the Court below granted a judgment against the respondent, Thomas, to only the *limited extent* of his partnership interest in his firm's short-swing profits. The Court further limited such recovery by refusing to allow any interest thereon.

This conscious limitation upon the partner-director's liability was apparently prompted by the Court's reliance upon its prior ruling to the same effect in the *Rattner* case, *supra*. However, the Court's reasons for limiting the partner-director's liability in *that* case found "further support in Rule X-16A-3(b) of the Securities and Exchange Commission which permitted a partner to file a report 'only as to that amount of such equity security which represents his *proportionate interest* in the partnership.' "

Shortly after the *Rattner* decision, the Commission amended its rule requiring the partner to report "*the entire amount* of such equity security owned by the partnership" (17 C.F.R. 240 16a-3(b); Append. p. 53). In view of such amendment of the rule, this ground, relied upon by the Court in the *Rattner* case, for limiting the partner-director's liability is no longer applicable. Indeed, the amended Rule would now seem to require a recovry from the partner-director of *all* the short-swing profits realized by the partnership.

The inconsistent standards of statutory interpretation which the Court below applied to the partnership, on the one hand, as against the partner-director, on the other, lends additional support to petitioner's argument that the fulfillment of the legislative purpose can only be accomplished if both the partnership and the partner-director are each held liable for *all* of the firm's short-swing profits.

Unless the statute is so construed as to hold both the partnership and the partner-director liable, jointly and severally, for *all* the "short-swing" profits realized by the *firm*, the stated Congressional purpose for its enactment will be defeated, and the doors will again be left wide open to indiscriminate stock manipulations, contrary to the public interest.

ARGUMENT.

I.

The congressional purpose and intent of Section 16(b) of the Securities Exchange Act of 1934 requires that respondent, Lehman Brothers, be held accountable for all short-swing profits realized by the firm.

Prior to the enactment of the Securities Exchange Act of 1934, Congress became aware of the fact that speculation in corporate stock by "insiders" of the companies involved was contrary to the public interest and was imperiling the economic structure of the United States.

The Congressional reasons for passage of the Act are fully and clearly set forth in Section 2 thereof.[1] In its purpose the Act "is aimed as an integrated entity toward the reform of the security markets by control of speculation and protection of the public against trading based on inside information and other abuses in the market machinery."[2]

The main purpose of the Act is to protect the millions of individual investors throughout the country who participate in the ownership of securities in public corporations. The Act seeks to ensure this great segment of the investing public that the securities exchanges which they use for the purchases and sales of corporate stock shall be maintained as fair, free and open markets, by prohibiting pool operations and other similar market manipulations, and by thwarting or punishing abuses of such market facilities. The Act is principally designed to prevent recurrence of abuses which contributed so greatly towards the stock market debacle of 1929.

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[1] 15 U. S. C. A., Sec. 78(b).

[2] 46 Yale L. J. 624, 629; See also, *Smolowe v. Delendo Corp.*, DCSDNY, 36 F. Supp. 790, 791; aff'd (2 C. A.) 136 F. 2d 231; cert. denied, 320 U. S. 751.

The Securities Exchange Act of 1934 recognizes that the primary cause of investor impotence is the "insider's" ability to control his corporation's stock in utter disregard of his fiduciary responsibilities towards and the rights of the investors whom he is presumed to represent.

National securities exchanges have greatly aided in the diffusion of corporate ownership since they have furnished the machinery which enables investors throughout the land to instantly buy or sell securities traded on such markets. Unless such investors are assured of obtaining accurate and sufficient information upon which they can form an independent opinion as to the values of securities traded upon such exchanges, and unless such exchanges are conducted fairly, as free and open markets, the prices at which such securities were purchased and sold would be reduced to a game of chance.

The provisions of the Securities Exchange Act of 1934, as a whole, seeks to protect the rights of the investing public. Section 16(b)[3] is closely related to the rest of the Act by adding the means of guaranteeing to the investor that the information, which he is entitled to obtain under the Act, shall not be made useless to him by the manipulations of "insiders" who have had the opportunity of taking full advantage of such information prior to public release thereof.

More particularly, Section 16(b) of the Act creates in any corporation listed upon a national securities exchange, and in its stockholders, the right to recover from any "insider" of such corporation all the profits realized from his purchases and sales of the corporation's equity securities within a period of less than six months.

Section 16(b) of the Act was adopted after a long and comprehensive Congressional investigation which disclosed

[3] Appendix, *infra*, p. 51.

numerous instances where "insiders" took advantage of confidential information by trading in their issuer's securities prior to any public disclosure of such information.[4] The Senate Committee on Banking and Currency, in its Report on Stock Exchange Practices, referring to Section 16(b), said:[5]

> "Among the most vicious practices unearthed at the hearings before the sub-committee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others."

Section 16(b) of the Act seeks to discourage such activities by providing that any profits realized by such "insiders" shall inure to the benefit of the corporation. Congress selected the corporation itself as the instrument to enforce this statutory policy but, recognizing that in most instances the corporation would be reluctant to sue its own directors, officers and large stockholders, the section provides that "if the issuer shall fail or refuse to bring such suit within sixty days after request, or shall fail diligently to prosecute the same thereafter," any security holder of the corporation may commence such action on its behalf.

The stated purpose of Section 16(b) is "preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer, by reason of

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[4] Senate Report No. 1455, 73d Cong., 2d Sess. (1934), pp. 55-68. See Loss, *Securities Regulation* (1951), pp. 561-98.

[5] Senate Report No. 1455, 73d Cong. 2d Sess. (1934), p. 55.

his relationship to the issuer." Congress thus attempted to close the avenue of proven abuses by "insiders" having *access* to corporate information which was not then available to the investing public.

In its effect Section 16(b) "was but a new approach to the common law attitude which had long recognized the reasonableness of enforcing a level of conduct upon fiduciaries 'higher than that trodden by the crowd.'" *Smolowe v. Delendo Corp.* (2 C. A.), 136 F. 2d 231, 239, cert. denied 320 U. S. 751.

Recovery under Section 16(b) is predicated upon an objective measure of proof and does not require any showing that the "insider" actually obtained confidential information or used it for his own benefit. As the Court stated in *Smolowe v. Delendo Corp., supra*, at page 236:

> "Had Congress intended that only profits from an actual misuse of inside information should be recoverable, it would have been simple enough to say so. Significantly, however, it makes recoverable the profit from any purchase and sale, or sale and purchase within the period. The failure to limit the recovery to profits gained from misuse of information justifies the conclusion that the preamble was inserted for other purposes than as a restriction on the scope of the act. * * *."

And in *Gratz v. Claughton* (2 C. A.), 187 F. 2d 46, 50, cert. denied 341 U. S. 920, in affirming a judgment against a defendant in a Section 16(b) action, the Court said:

> "* * * If only those persons were liable who could be proved to have a bargaining advantage, the execution of the statute would be so encumbered as to defeat its whole purpose. We do not mean that the interest, of which a statute deprives an individual, may never be so vital that he must not be given a trial of his personal guilt; but that is not so when all that is at stake is a director's officer's or 'beneficial owner's' privilege to

> add to, or subtract from, his holdings for a period of six months. In such situations it is well settled that a statute may provide any means which can reasonably be thought necessary to deal with the evil, *even though it may cover instances where it is not present.* * * *" (Italics supplied.)

It is quite clear that the statute is wholly unconcerned with either the fairness of a particular transaction or the "insider's" good faith or good intentions in effecting it. Its principal purpose is to *deter* the "insider" from purchasing and selling his listed issuer's securities within a period of less than six months by causing him to surrender all profits which he may have realized from such transactions.[6]

In the course of the Congressional hearings, one of the draftsmen of the Act testified that Section 16(b) is designed to reach an "insider's" short-swing profits "irrespective of any intention or expectation to sell the security within six months," since it is "absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended at the time he bought, to get out on the short-swing."[7]

Section 16(b) of the Act as finally passed by the Congress provides that the liabilities imposed thereunder shall be enforced "irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months."

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[6] *Grossman v. Young* (DCSDNY), 70 F. Supp. 970, 971, 972; *Carr Consolidated Biscuit Co. v. Moore* (DCMD Pa.), 125 F. Supp. 423, 427; *Stella v. Graham Paige Motors Corp.* (C. A. 2), 232 F. 2d 299, 302.

[7] Hearings before the Senate Committee on Banking and Currency on S. 84, 73rd Cong., 1st Sess. (1934), p. 6557.

It is thus quite evident from the legislative history of Section 16(b) and the final form of the statute itself that, in a sense, the provisions stated therein merely reiterate the specific application of the time-honored principle that a fiduciary may engage in no activity which may, by even a remote possibility, involve a conflict of interest between his official duties and his private interests. *Michaud v. Girod*, 4 How. 503, 559; *Magrueder v. Drury*, 235 U. S. 106; *Pepper v. Litton*, 308 U. S. 295.

In their interpretations of this section of the Act, the Courts have consistently sought to close all avenues leading to any possible evasion of its provisions (*Smolowe v. Delendo Corp., supra*), so as "to carry out in particular cases the generally expressed legislative policy,"[8] by striking down "*any means* by which insiders, because of their special knowledge of the affairs of the corporation or the plans of its board of directors might realize for themselves a 'short-swing' profit, which would be denied the other stockholders or investing public not enjoying such inside information."[9]

A singularly important exception to such consistent interpretation of the statute has been made by the United States Court of Appeals for the Second Circuit in the case of an investment partnership firm which has realized profits from its short-swing transactions in the securities of a listed corporation upon whose Board one of the firm's partners is a director. The Court has refused to hold the *partnership firm* liable for any of the short-swing profits realized by *it*, while *limiting* the recovery from the *partner-director* to only his proportionate partnership interest therein.[10]

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[8] *Securites and Exchange Commission v. C. M. Joiner Leasing Corp.*, 320 U. S. 344, 350, 351.

[9] *Kogan v. Schulte* (DCSDNY), 61 F. Supp. 604, 608, aff'd *sub. nom.; Park & Tilford, Inc., v. Schulte* (C. A. 2), 160 F. 2d 984, cert. denied, 332 U. S. 761.

[10] *Rattner v. Lehman* (C. A. 2), 193 F. 2d 564; *Blau v. Lehman* (C. A. 2), 286 F. 2d 786, cert. granted, 81 S. Ct. 1048.

The anamoly in thus departing from its own expressed and accepted standards for interpreting the legislative intent and purpose of the statute led Judge Clark to remark in his dissenting opinions below that the majority of the Court has *judicially* exempted an investment partnership firm from any liability "in the very case where the incentive to take insiders' profits is strongest as a part of a trading firm's normal business," and that "the most serious vice" of the court's decision "is the unfair discrimination it builds into an important remedial statute —a discrimination substantially eliminating the great Wall Street trading firms from the statute's operation."[11]

Although Judge Medina, writing the majority opinion for the Court below in the case at bar, recognized that "there is only one way to prevent stock manipulation by insiders to whom confidential information is available," and that is "to construe Section 16(b) to include the partnership because of the unity of the partnership relationship and the fact that one of the partners is a director," he, nevertheless, insisted upon following the Court's prior decision in *Rattner v. Lehman* (C. A. 2), 193 F. 2d 564.[12]

The principal reason relied upon by the Court below in the *Rattner* case, *supra*, for absolving the partnership from any liability under the statute, while limiting the partner-director's liability thereunder, was its *literal* interpretation of Section 16(b), which provides for the issuer's right to recover from a director "any (short-swing) profits *realized by him*." By restricting the application of the statute to its *literal* interpretation, the Court, in effect, repudiated its prior decisions which had emphasized repeatedly that Section 16(b) must be construed broadly so as to effectuate its legislative purpose. Moreover, even upon such a *literal* interpretation of the statute, since each

[11] *Blau v. Lehman, supra*, pp. 793, 799; R. 187, 202, 203.

[12] *Blau v. Lehman, supra*, p. 791; R. 182.

partner is "co-owner" of all property purchased with partnership funds and has an equal right with his other partners to possession therein, the elimination of any recovery of the full partnership liability can only be sanctioned if the legal meaning of "owner" in Section 16(a) of the Act is construed to exclude a "co-owner."

Although the *results* reached by the Court below in the instant case were identical to those in the *Rattner* case, *supra,* the different standards applied for interpreting Section 16(b) were so inconsistent and contradictory as to be irreconcilable.

In its majority opinion, the Court below expressly acknowledged that since Section 16(b) is a "broadly remedial statute," the application of its provisions requires a *broad* interpretation to effectuate its legislative purpose; that an interpretation of the statute which holds the partnership liable thereunder is "one way to do this." The Court then proceeded to wholly disregard its own recognized standards of broad statutory application by *absolving* the partnership from any liability whatsoever. In arriving at such an inconsistent result, the Court stated that it felt "bound" by its prior ruling in the *Rattner* case, *supra,* which was predicated upon a *literal* interpretation of Section 16(b).

The inconsistent standards, which the Court below applied in its interpretations of the statute, becomes even more pronounced in view of its exceptional treatment of the partner-director's liability.

Since the partner-director, Thomas, had waived his right to share in the short-swing profits realized by the partnership, any *literal* interpretation of the statute obviously would have absolved him from any liability thereunder. Recognizing, however, that any such *literal* application of the statute would flout its legislative purpose, the Court below concededly interpreted th provisions of Section

16(b) "*broadly*" and imposed the statutory liability upon the partner-director. Refusing to continue its broad application of the statute with respect to the *amount* of such partner-director's liability thereunder, and insisting, in this phase of the case, upon following the *literal* interpretation accorded to the statute in the *Rattner* case, —although the fruition of the legislative purpose, in this instance, equally required a broad statutory application— the Court expressly *limited* the partner-director's liability to only his proportionate partnership interest in his firm's short-swing profits.

II.

The respondent, Lehman Brothers, was an "insider" of Tide Water within the meaning and intent of Section 16(b) of the Act and, therefore, was liable for all short-swing profits realized from its transactions in Tide Water's preferred stock.

A. The respondent, Lehman Brothers, deputed its partners to represent its interests on the Tide Water Board.

The record clearly demonstrates that Lehman Brothers deputed its partners to represent the firm's interests as directors on Tide Water's Board.

The sequence of events first indicating any association or connection between Lehman Brothers and Tide Water goes back to the year 1934 when Mr. John Hertz, one of Lehman Brothers partners, was first elected to the Tide Water Board. Mr. Hertz continued being a member of Tide Water's Board from that date until August 5, 1954, when his resignation therefrom became effective.

Mr. Hertz candidly testified (R. 62a) that "I came here (to Lehman Brothers) to bring business to Lehman Brothers, and I devoted my time to it, * * *."

In response to a question as to whether his being a director of Tide Water brought any business to Lehman Brothers, Mr. Hertz responded (R. 62a):

> "I am sure it did. It surely brought Tide Water business."

The following testimony by Mr. Hertz is irrefutable proof that he joined Tide Water's Board as a director for the sole purpose of representing and fostering Lehman Brothers interests (R. 65a).

> "Q. Is it the practice of Lehman Brothers to have some of its partners go on boards of corporations in order to further the interests of Lehman Brothers? A. Well, I surely joined Tide Water Company thinking it was going to be in the interests of Lehman Brothers."

Mr. Hertz admitted that during his tenure as a director of Tide Water he "gossiped" about its affairs with his partners at Lehman Brothers (R. 63a).

The only logical inference to be drawn from the aforesaid facts is that Mr. Hertz *literally* represented the interests of Lehman Brothers as a director on Tide Water's Board.

The record conclusively demonstrates that the continuity of Lehman Brothers representation upon Tide Water's Board remained unbroken even after Mr. Hertz had resigned as a director.

A short time prior to his resignation, Mr. Hertz spoke to his partner, respondent, Joseph A. Thomas, and "asked him whether he would like to go on the board, and he (Thomas) said he would." Mr. Hertz thereupon "spoke to the president of the Tide Water Company" and recom-

mended that Mr. Thomas replace him (Hertz) as a director. Pursuant to such recommendation, Mr. Thomas was appointed to the Tide Water Board on August 5, 1954, the date Mr. Hertz's resignation became effective (R. 64a).

Mr. Hertz honestly admitted that his chief purpose in recommending Mr. Thomas as a Tide Water director was to further the interests of Lehman Brothers by such representation (R. 65a).

It is traditional partnership law that "Every partner is an agent of the partnership for the purpose of its business." See New York Partnership Law, Section 20.

Legally, therefore, Mr. Hertz's recommendation that Mr. Thomas be appointed to the Tide Water Board actually represented *the act of the partnership firm of Lehman Brothers;* the *firm itself* deputed Mr. Thomas to become a member of the Tide Water Board so that the partner-director would represent and foster the firm's interests thereby. How well this succeeded will hereinafter be discussed more fully.

Petitioner offered proof at the trial that the designation and appointment of Mr. Thomas as a Tide Water director was in no sense fortuitous but represented a preconceived plan and design which had been followed by Lehman Brothers consistently throughout the years not only as respects Tide Water but numerous other corporations as well.

Thus, Mr. Monroe C. Gutman, one of Lehman Brothers partners testified that "There are times when it has been suggested" by the firm that its members be appointed as directors of various corporations (R. 79a). Mr. Gutman further testified that where Lehman Brothers does any business with a corporation upon whose board one of his partners is a director, this particular partner-director

"would be one of those who would be consulted" by Lehman Brothers "because he would be cognizant of what is going on" (R. 78a).

The record is crystal clear that Joseph A. Thomas, the partner-director on Tide Water's Board, was, indeed, "consulted" by Lehman Brothers prior to that firm's "short-swing" transactions in the Tide Water stock. Mr. Thomas testified that after he had become a director, certain members of his partnership firm, *including Mr. Hammerslough, the firm's partner who actually authorized its purchases of Tide Water stock,* discussed the policies, management and prospects of the corporation with him and Mr. Thomas "suggested" that "Tide Water under the new management was an attractive investment" (R. 54a-56a). Mr. Hammerslough also testified "that Thomas spoke very highly of the management and prospects of the Tide Water Oil Company" and "thought very highly of it" (R. 69a).

In order to further demonstrate that Mr. Thomas' appointment as a director to Tide Water's Board was initiated by Lehman Brothers pursuant to a definitive plan to have Mr. Thomas represent the firm's interests thereon, petitioner attempted to read into evidence the respondents' answers to a Notice to Admit which indicated a systematic plan to perpetuate various partners of Lehman Brothers as directors in at least ten (10) different corporations taken at random with whom the partnership was doing business (R. 9a-21a).

The Trial Court refused to allow these facts to be introduced into evidence ruling them "irrelevant." Petitioner thereupon made a full offer of proof with respect thereto (R. 87a-98a).

In *United States v. Morgan, et al.* (DCSDNY), 118 F. Supp. 621, the Court found as a fact that it was the

policy of Lehman Brothers to place its partners or employees on the boards of various corporations to obtain and hold business, stating (p. 715):

> "* * * It was a matter of policy with them (*Lehman Brothers* and Goldman Sachs) to place partners or employees on the boards of directors of issuers, and there is evidence that they each used the presence of such men on these boards in various ways in support of their competitive efforts, partly to get business but principally to hold on to such business, once it had been secured."

The case of *Lehman, et al., v. Civil Aeronautics Board*, 209 F. 2d 289, cert. denied 74 S. Ct. 513, is peculiarly pertinent to the issues here involved. In that case the facts were as follows:

Under Section 409(a) of the Civil Aeronautic Act of 1938, it is unlawful for an air carrier to have as a director one who is also a director of a common carrier unless the particular relationship is approved by the Civil Aeronautical Board (herein referred to as CAB), upon a showing that the public interest will not be adversely affected.

A number of Lehman Brothers partners were directors of different corporations engaged as common carriers. CAB instituted proceedings to determine whether any of the members of the Lehman Brothers partnership who served as directors in any phase of aeronautics were or might be "representatives" of other partners who were directors of other such corporations.

CAB disapproved the membership of various Lehman Brothers partners as directors of different carriers upon the ground that "whenever the partner's acts as a director might further the interest of the partnership in accordance with the intended purposes of the firm in performing such acts, it must be concluded that the partner *represents* the firm."

In affirming the decision of the CAB, the Court of Appeals said (pp. 292-294):

> "Petitioner, Lehman, is a director of Pan American; petitioner, Joseph A. Thomas, is a director of National Airlines, Inc. and of American Export Lines, Inc.; petitioner, Frederick L. Ehrman, is a director of Continental Air Lines, Inc., and Mr. John D. Hertz is a director of Consolidated Vultee Aircraft Corporation. All the companies referred to are in the aeronautic field and so must have Board approval of the kind of interlocking relationships which are made unlawful unless approved. Messrs. Lehman, Thomas, Ehrman, Hertz and others, are also members of Lehman Brothers, a partnership which, as previously pointed out, conducts an investment banking business.
>
> "The Board held that an individual Lehman Brothers partner who is a director of a Sect. 409(a) Company is a representative of another partner who is a director of another such company. The relationships thus found to exist were disapproved. * * *.
>
> "More precisely the Board concluded that a Lehman Brothers partner who is a director of an air carrier has a representative 'who represents such * * * director as * * * a director' in another Sect. 409(a) company if another Lehman Brothers Partner is a director of the latter, coupled with the circumstances that he seeks on behalf of Lehman Brothers the security underwriting and merger negotiation services used by the Company of which he is director. *The underwriting of security issues and the conduct of merger negotiations constitute a substantial part of the business of Lehman Brothers, who have been employed for these purposes not infrequently by Sect. 409(a) companies. The partners feel free to select this business for their firm.*
>
> *"The underwriting activities of Lehman Brothers is a substantial part of its business;* substantial fees are also obtained by Lehman Brothers from merger negotiations. *Profits from the fees are*

shared by the partners. Sect. 409(a) companies, with Lehman Brothers partners as directors, need to use both type of services, *and the partner directors seek such business for the partnership. In doing so they act as representatives of the partnership.* It follows that they act as representatives of fellow partners, some of whom are directors of air carriers. * * * Does Mr. Thomas, to use his case as illustrative, who is a Lehman Brothers partner and also a director of National Airlines, *represent, as a director of National Airlines, Mr. Lehman, another Lehman Brothers partner and director of Pan American?* We think that the affirmative answer of the Board should not be disturbed. For the situation comes to more than some community of interest and some sharing of common benefits as partners. The partnership link does not extend merely to a type of business remote from the aeronautical industry in which the partners are directors. * * * In these activities there is not only literal representation by one partner of another in partnership business but the particular partnership business is as well the business of aeronautical enterprises of which the partners are directors. When Mr. Thomas, again to illustrate, as director of National seeks to guide that company's underwriting business to Lehman Brothers he acts in the interest and for the benefit of Mr. Lehman who is not only his underwriting partner but is also a director of an air carrier, Pan American. *Mr. Lehman the partner is the same Mr. Lehman the director.* The Board is not required to separate him into two personalities, as it were, and to say that Mr. Thomas represents him as a partner but not as a director. * * *. *The undoubted representation which grows out of the partnership we think follows into directorships when the transactions engaged in are not only by the partners but concern companies regulated by the statute of which the partners are directors.* This is representation within not only the langauge but the meaning of the statute." (Italics supplied.)

A discussion of the *Lehman* case, *supra*, highlights the rationale of the Court's opinion in *42 Georgetown L. J. 141, 143*, in the following fashion:

> "The Court in the instant case, however does not derive its interpretation solely from the partnership relationship. The majority opinion states that partners would not be considered representatives of one another if they were members of 'a partnership which owns a *drug store*.' The additional element which enables them to find that in this case one partner is the representative of another is the fact that *Lehman Brothers engages in extensive underwriting and merger negotiation business and 'the partner directors seeks such business for the partnership.'* From this they conclude that an element of representation exists. * * *." (Italics supplied.)

Apart from a judicial determination by the Court in *Lehman, et al., v. Civil Aeronautics Board, supra*, that "The underwriting activities of Lehman Brothers is a substantial part of its business" and that "the partner directors seek such business for the partnership" and "so they act as representatives of the partnership"—*these facts were independently proven in the instant case.* Mr. Thomas testified that the defendant, Lehman Brothers, was in the business of "Investment banking, generally" (R. 32a). Mr. Gutman, another partner of Lehman Brothers, testified as follows (R. 76a-77a):

> "Q. Has your firm had any business dealings with Tide Water Associated Oil Company? A. I think they participated in an issue for the Tide Water Oil Company some time in the last year or so. I don't know exactly when it was.
>
> "Q. Prior to this past year have you had any business dealings with Tide Water? A. In the past we did some financing for them, I believe."
>
> * * * * * *
>
> "Q. Who in your organization was assigned to the Tide Water financing business? A. In Tide

Water financing business, it was done by Mr. Thomas. I think he was assisted by some of the staff. He probably had assistance from other partners, too. I don't know the details. As a rule, he is apt to have.

"Q. Did he discuss these matters with the other partners? A. I don't remember the details, Mr. Levy, but I am sure, before undertaking a commitment for the firm to do public financing, it was discussed at a partners' meeting. Frankly, I don't remember that discussion, but I think it probably was."

It requires no further elaborate argument to see that in attempting to obtain the Tide Wat[illegible] business for his firm, Mr. Thomas, the partner-director, was actually actively representing the interests of Lehman Brothers on Tide Water's Board. The record is clear that Mr. Thomas was deputed by Lehman Brothers to represent its interest on the Tide Water Board and that he performed this job very well.

B. The respondent, Lehman Brothers, was a "insider" of Tide Water within the meaning and intent of Section 16(b), and, therefore, subject to its provisions.

Since the respondent, Lehman Brothers, deputed its partner, Joseph A. Thomas, to represent the firm's interests on Tide Water's Board, the partnership itself was an "insider" of Tide Water within the meaning and intent of Section 16(b) of the Act and must account for all short-swing profits realized by it.

While it is true that Section 16(b) of the Act does not by its *express language* provide that a partnership shall be liable for the profits realized from its short-swing transactions in the securities of a corporation upon whose Board one of its partners is a member—the very nature

and business of the partnership relationship naturally contemplates such a result for the fulfillment of its Congressional purpose.

It is a well settled principle of law that a trustee's firm may not benefit from transactions with the trust.

Thus in *In re Los Angeles Lumber Products Co.* (DCSD Calif.), 37 F. Supp. 708, an analagous situation to the case at bar arose under Section 249 of the Bankruptcy Act which provides that "No compensation or reimbursement shall be allowed to any * * * attorney * * * who has purchased or sold * * * stock (of the debtor)."

A firm of attorneys traded in the bonds of the debtor despite the participation in the reorganization proceedings of one of the partners of the firm. In denying compensation to the *firm* the Court said (p. 711):

> "It is contended here that, although Mr. Faries may be barred from compensation, the firm of which he is a member is in a different position. We must then decide whether or not those partners who were ignorant of Mr. Faries' bond transactions —if, indeed, there were any such partners—or those partners who did not participate in the transactions, should be permitted to receive any share of the compensation to which the firm would normally be entitled. The court feels in a situation such as this, each member of a law firm should share the responsibility for the individual acts of another partner or other partners. To construe Section 249 otherwise would largely destroy its effectiveness. *The relationship between partners is too close to make it possible to insure that compensation allowed to an innocent partner may not ultimately benefit a guilty partner, directly or indirectly. If Section 249 were to be construed as suggested, it might be possible to work out evasions of its provisions whereby one partner traded*

while another did legal work. Such a situation would be intolerable. See *Tracy v. Willys Corporation*, 6 Cir. 1930, 45 F. 2d 485." (Italics supplied.)

In recognizing that "Large areas of 'insider' conduct were consciously left untouched by Congress for reasons dictated by practicalities rather than ethics or pure logic," and that Section 16(b) must be interpreted to fully carry out the purposes intended for it by Congress, the Court stated the following in *Adler v. Klawans* (C. A. 2), 267 F. 2d 840, 844-845:

> "At most our task is, in Judge Cardozo's words, that of filling 'the open spaces in the law.' In addition to the intent and purpose of the legislation which we must glean from the statute as a whole rather than from isolated parts, we must consider the results which would flow from each of the two interpretations contended for. *If we find one interpretation tends to carry out and the other to defeat the purposes of the statute, the resolution of the issues becomes simple.*
>
> "The undoubted Congressional intent in the enactment of Section 16(b) was to discourage what was reasonably thought to be a widespread abuse of a fiduciary relationship * * *.
>
> * * * * * *
>
> "Large areas of 'insider' conduct were consciously left untouched by Congress for reasons dictated by practicalities rather than ethics or pure logic. A line had to be drawn somewhere by the lawmakers as they must do in the laws of marriage, divorce, legitimacy, real estate, wills and a host of other subjects governed by statute. *But the consciously limited scope of the statute is no reason for us to seek yet further limitations of what is remedial legislation.*" (Italics supplied.)

In *Stella v. Graham-Paige Motors Corp.* (C. A. 2), 232 F. 2d 299, cert. denied, 352 U. S. 831, the Court affirmed the judgment of the district court which held that the purchase of securities which made a person a 10% stockholder

must be *included* in the short-swing transaction nothwithstanding the express provisions set forth in Section 16(b) of the Act,[13] because such interpretation of the statute would truly effectuate the Congressional purpose and not defeat it. The opinion of the district court in the *Stella* case, *supra* (104 F. Supp. 957, 959), clearly demonstrates the logical reasons for such an interpretation in the following language:

> "The purpose of Congress is a dominant factor in the determination of a statute's meaning, *United States v. C. I. O.*, 1948, 335 U. S. 106, 112, 68 S. Ct. 1349, 92 L. Ed. 1849, and where a choice may be made between two possible constructions, that construction should be chosen which would serve to effectuate Congressional purpose rather than defeat it. 'However well (rules of statutory interpretation) may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permit *so as to carry out in particular cases the generally expressed legislative policy.*' *Securities and Exchange Commission v. C. M. Joiner Leasing Corp.*, 1943, 320 U. S. 344, 350-351, 64 S. Ct. 120, 123, 88 L. Ed. 88." (Italics supplied.)

In *Colby v. Klune* (C. A. 2), 178 F. 2d 872, the Court was called upon to decide whether an *employee* performing important duties for his issuer, ***but who was neither a legally designated director nor officer thereof***, could be held legally accountable for "short-swing" profits realized by him, solely because "he would be likely, in discharging these duties, to obtain confidential information about the

[13] The last sentence of Section 16(b) provides that "This subsection shall not be construed to cover any transaction where such beneficial owner (10% stockholders) was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, * * *."

company's affairs that would aid him if engaged in personal market transactions." In reversing the District Court's dismissal of the complaint and remanding the matter for further proof, the Court said (p. 873):

> "* * * we construe 'officer,' as used in Section 16(b) of the Securities Exchange Act, thus: It includes *inter alia*, a corporate employee performing important executive duties of such character that he would be likely, in discharging these duties, to obtain confidential information about the company's affairs that would aid him if engaged in personal market transactions. It is immaterial how the functions are labelled or how defined in the by-laws, or that he does or does not act under the supervision of some other corporate representative. * * *"

It is obvious that Congress never intended the term "director," as used in Section 16(b) of the Act, to be construed in a narrow, limited and literal manner. Significantly, Congress expanded the definition in a broad, unrestricted sense to fully accomplish the purposes of the statute. Section 3(a) (7) of the Act, 15 U. S. C. A. Sect. 78c (a) (7), specifically provides as follows:

> "The term 'director' means any director of a corporation *or any person performing similar functions* with respect to any organization, whether incorporated or unincorporated." (Italics supplied.)

That the term "person" as used in the aforesaid Section encompasses a partnership such as the defendant, Lehman Brothers, is specifically set out in Section 3(a) (9) of the Act, 15 U. S. C. A. Sect. 78c (a) (9), which provides as follows:

> "The term 'person' means * * * a partnership, * * *"

As this Court stated in *United States v. A & P Trucking Co.*, 79 S. Ct. 203, 358 U. S. 121, at page 206, Note 3:

"Congress has specifically included partnerships within the definition of 'person' in a large number of regulatory Acts, thus showing its intent to treat partnerships as entities. * * *"

The close relationship between Joseph A. Thomas and his partners was such as to constitute them collectively a "person" within the meaning of the foregoing section. The defendant, Lehman Brothers, acting as an entity, and having its firm interests represented on the Tide Water Board by its partner-director Mr. Thomas, had the same influence and access to confidential information as the *legally designated* director of the corporation. The partnership, therefore, was a "director" of Tide Water within the meaning and intent of Section 16(b) and subject to its provisions.

The record demonstrates beyond per-adventure that the purchases by Lehman Brothers of Tide Water common stock, its subsequent conversions into preferred shares and sales thereof within a six-month period, were predicated upon information concerning the affairs of Tide Water which had been imparted to Lehman Brothers by its partner-director, Mr. Thomas.

Mr. Hammerslough, one of the partners of Lehman Brothers, testified that he and two other partners were the "formal members" of the firm's Portfolio Committee and that "all other partners were invited at times to attend the meetings." Mr. Hammerslough further testified that *he* personally authorized the purchases by his firm of Tide Water common stock *after* he had fully discussed the matter with his partners, and they had concluded "that this preferred stock into which the common was going to be exchanged * * * would be a very, very safe, good investment, and would be attractive, once it was issued, to institutional investors throughout the country." Mr. Hammerslough further testified that he had several discussions concerning the affairs of Tide

Water with Mr. Thomas after the latter had become a director of the corporation and "that Thomas spoke very highly of the management and prospects of the Tide Water Oil Company" and "thought very highly of it" (R. 69a-71a).

It is even more significantly evident, in the light of Mr. Thomas' testimony, that the decision of Lehman Brothers to purchase Tide Water common stock for the purpose of converting it into preferred shares and then selling the latter stock was wholly predicated upon the facts and opinions of Tide Water's affairs which Mr. Thomas disclosed to at least six (6) of his partners in the firm, including Mr. Hammerslough. Mr. Thomas testified as follows (R. 54a-56a):

> "Q. You have been asked by certain members of your firm what you thought of (Tide Water) management? A. Yes.
>
> "Q. And what you thought of the policies that they were formulating? A. That is right.
>
> "Q. And what your opinions were concerning the effect they would have upon the business? A. That question I can't answer.
>
> "Q. Can't? A. Can't. I have answered in the affirmative that I have said that I thought the management was good and I thought their general objectives were first-rate.
>
> "Q. Can you recall with whom you had those conversations? A. No, I can't.
>
> "Q. Was it with one or more of your partners? A. It might have been.
>
> * * * * * *
>
> "Q. Mr. Gutman? A. Mr. Gutman I would unquestionably have discussed it, because he is very much interested in the oil business, generally speaking.
>
> * * * * * *
>
> "Q. How about Mr. Hammerslough? A. Yes, I have talked to Bill from time to time about it.

"Q. Mr. Callery? A. Yes, I should have mentioned Mr. Callery. Mr. Callery is very knowledgeable of the oil business. I should have mentioned him before.

* * * * * *

"Q. Mr. Fell? A. Yes.

* * * * * *

"Q. Mr. Kennedy? A. Yes.

"Q. Mr. Manheim, Frank or Paul? A. Paul, yes; Frank, no.

* * * * * *

"Q. With whom do you say you had most extensive conversations concerning these matters? A. Gutman, Hammerslough and Kennedy.

"Q. Were these gentlemen members of the committee of Lehman Brothers as you mentioned who selected various investment portfolios for Lehman Brothers? A. Kennedy certainly not. Mr. Gutman was at one time, and Mr. Hammerslough I think has been a member of the portfolio committee right along.

"Q. Did you at any time discuss with any of these gentlemen the advisability of your firm, Lehman Brothers, purchasing stock in Tide Water? A. No, not as a firm investment. I have suggested from time to time that I thought Tide Water under the new management was an attractive investment.

"Q. You had suggested that to— A. Not only to individuals of my own firm but to a great many people on the outside, because that is my belief.

"Q. But you had suggested that to members of your firm and told them that it would be a good investment for them? A. When the new management came in, *my opinion was asked of what I thought of it*, and after I watched them in, I expressed my opinion freely that I thought the management was first-rate, that the company would do well under that management.

* * * * * *

"Q. Who asked your opinion concerning that? A. Some of the gentlemen that you mentioned."

In his dissenting opinion in the Court below Judge Clark aptly pointed out that "Unless judges are to be incredibly naive as to the facts of financial life, it is difficult to see what Thomas needed to say more to show that the lily was already gilded."[14]

A subdivision of Section 16 of the Act, as originally proposed, made it unlawful for an "insider" to disclose confidential information to another person and provided for the recovery of "short-swing" profits from the person to whom such information was disclosed. See *Hearings before Senate Committee on Banking and Currency in S. Res. 84, 72d Cong. 2d Sess. and S. Res. 56 and 97, 73d Cong., 1st and 2d Sess.* (1934), page 6560; *Hearings before House Committee on Interstate Commerce & Foreign Commerce on H. Res. 7852 and 8720, 73 Cong. 2d Sess.* (1934), pages 135-137.

Section 16(b), as finally adopted, omitted this provision because of the doubt as to its administrative practicability. As the Court said in *Smolowe v. Delendo Corp.*, C. A. 2, *supra* (p. 236):

> "* * * Furthermore, provisions in the early drafts, declaring unlawful the improper disclosure of confidential information regarding securities by directors, officers or principal stockholders, and holding that any profit made by any person to whom such unlawful disclosure was made should inure to the corporate issuer, were deleted, presumably because the burden of proof made enforcement unfeasable."

Recovery under Section 16(b) does not require any showing that the director or officer actually obtained confidential information by reason of his opinion, or utilized such information.

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[14] *Blau v. Lehman, supra*, p. 795; R. 190.

Where, however, a partner-director *does* impart such inside information to his firm which might tempt it to engage in short-swing trading, unless the *entire* short-swing profits are recoverable *jointly and severally* from the director-partner and his firm, there would be absolutely no deterrent for the partner-director to pass on such inside information to his firm *for the mutual profit of all the members therein.*

Respondent, Lehman Brothers, has contended that it is not liable for the short-swing profits realized from its transactions in the Tide Water stock because the firm was not *a literally designated* director or officer of the corporation.

If its contentions were sustained under the peculiar facts of this case, emasculation of the Act would completely nullify its declared prophylactic purpose, and evasion of the provisions of Section 16(b) would be relatively simple. The respondent, Lehman Brothers, could under such circumstances engage with impunity in short-swing transactions in the numerous corporations upon whose Boards one of its partners is a director, reaping short-swing profits from stock transactions predicated upon confidential information disclosed to the firm by the partner-director who actually represented the *firm's* interests. The only penalty, according to Lehman Brothers' reasoning, should be against the partner-director *alone*, and it should be *limited* solely to *his* proportionate partnership interest.

It may reasonably be assumed that the partnership would not allow the particular partner-director to sustain a personal financial loss while the firm reaped the benefits from its member's beneficent activities on its behalf. The partnership undoubtedly would feel morally obligated at least to reimburse such partner and would find *some* way to accomplish this result.

Mutual "back-scratching" by the individual partners would redound to the partnership coffers and eventually find its way back to that particular partner-director whose activities on its behalf directly benefited the firm.

Indeed, apart from any such *moral* obligation, it would appear that the partnership is *legally* obligated to reimburse such partner-director. Thus, *Section 40 of the New York Partnership Law*, in so far as is here material, provides as follows:

> "2. A partnership must indemnify every partner in respect of payments made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business, or for the preservation of its business or property."

Section 24 of the New York Partnership Law provides that:

> "Where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership, or with the authority of his co-partners, * * * any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act."

It is traditional partnership law that each partner has an undivided interest in the *entire profits* realized by his firm, and is jointly and severally liable for anything chargeable to it. See *Section 26 of the New York Partnership Law*.

These legal concepts are even more applicable to the liability created by Section 16(b) of the Act since its asserted purpose, evincing a definitive public policy, is "preventing the unfair use of (inside) information."

Accordingly, the only way to foreclose all possible avenues for evading the statute and truly effectuating its intended purpose is to hold the *partnership*, Lehman Brothers, liable for *all* profits realized by it from its short-

swing transactions in an issuer's securities where one of its partners is a director of such issuer and has been deputed to represent the firm's interests on the issuer's Board.

This has been judicially recognized in *Rattner v. Lehman*, C. A. 2, 193 F. 2d 564, in an opinion written by Judge Learned Hand, as follows (p. 566):

> "* * * Therefore, I think we may dispose of the appeal on the assumption that Lehman Brothers bought and sold the shares without any advice or concurrence by Hertz; and the only question is whether partners are liable for whatever profits the firm may make whenever one of their members is a director, *and only because he is a director.* I agree that Section 16(b) does not go so far; but I wish to say nothing as to whether, *if a firm deputed a partner to represent its interests as a director on the Board*, the other partners would not be liable. True, they would not even then be *formally* 'directors'; *but I am not prepared to say that they could not be so considered;* for some purposes the common law does treat a firm as a jural person * * *." (Italics supplied.)

Under the particular facts in the *Rattner* case, *supra*, the Court refused to hold the partnership liable for the short-swing profits which it realized, but affirmed a judgment against the partner-director for his proportionate partnership share of such profits. One of the grounds for this decision was the fact that *there was no evidence in the record* that Lehman Brothers had deputed its partner-director to represent its interests upon the issuer's Board, *and there was no evidence in the record* that the partner-director had disclosed any corporate information to the partnership. The plaintiff in that case presented

no proof with respect to the aforesaid facts but relied *solely* upon the naked proposition that a partnership is liable for all profits realized from its short-swing transactions in an issuer's securities *only because* one of its partners is a director of such issuer.

In the instant case, however, the record is abundantly clear that Lehman Brothers *actually deputed* its partner, Joseph A. Thomas, to represent its interests upon the Tide Water Board, and that Mr. Thomas *did disclose* to his firm certain information about Tide Water which he had acquired as a result of his fiduciary position, and that the short-swing transactions by Lehman Brothers were actually predicated upon such information.

Parenthetically, it may also be noted at this point that Mr. Thomas was fully aware at the time that Lehman Brothers was purchasing the common stock of Tide Water, that the firm's purpose was "to convert it and sell it because it is a high-grade stock and very desirable for institutional investors" (R. 49a).

Sound public policy in the enforcement of Section 16(b) requires that *all* profits realized by Lehman Brothers from its short-swing transactions in the Tide Water stock should be recovered from the *partnership*. Any other interpretation of the statute would be contrary to the Congressional purpose and would open the doors wide to indiscriminate stock manipulations by such corporate insiders.

III.

The partner-director, Joseph A. Thomas, is liable for *all* the profits which respondent, Lehman Brothers, realized as a result of its short-swing transactions in the Tide Water stock.

The Court below *limited* the liability of the partner-director, Joseph A. Thomas by holding him accountable to Tide Water for only his *proportionate partnership share* of the short-swing profits realized by respondent, Lehman Brothers.

To construe Section 16(b) of the Act in such a manner that it will not reach under *any* circumstances more than a partner-director's proportionate share of his firm's short-swing profits is both unrealistic and perversive of the true legislative intent and purpose of the statute.

While it is true that in *Rattner v. Lehman* (C. A. 2), 193 F. 2d 564—followed by the Court below in this case —the partner-director was similarly held liable to the issuer for only his proportionate partnership share of the firm's short-swing profits, the *rationale* of the Court's opinion in that case was predicated *solely* upon the peculiar facts there involved. The Court stated that its reason for thus limiting the partner-director's liability stemmed from the fact that "the purchases and sales of Vultee Aircraft stock were made *without the knowledge* of Mr. Hertz (the partner-director)."

It would thus appear from the opinion in the *Rattner* case, *supra,* that where the partner-director has had "*knowledge*" of his firm's short-swing transactions, he would have been held liable for the *entire amount* of the partnership profits.

An analogous situation occurred in *Jefferson Lake Sulphur Co. v. Walet* (C. A. 5), 202 F. 2d 433, cert. denied, 346 U. S. 820, which was decided *subsequent* to the *Rattner* case, *supra*. In that case, the defendant, Walet, an officer of a listed corporation, was married and resided in the State of Louisiana, where the wife has a vested one-half interest in all marital property. The defendant had purchased and sold his issuer's stock within a six-month period, realizing profits therefrom. When the issuer instituted suit to recover the *entire* amount of such profits, the defendant sought to have his liability limited to only his proportionate community share of such profits, i. e., one-half.

In overruling the defendant's contention and holding him liable for *all* the short-swing profits, the Trial Court said (104 F. Supp. 20, 24):

> "Under Section 16(b) of the Securities Exchange Act any profit realized by the defendant in his short term transactions must inure to the corporation. The only way to execute the congressional mandate in this case is for the corporation to receive all of the profit from these transactions, because any profit, however small, not recovered by the corporation, remains in the community in which the defendant has an indivisible one-half interest and over which, incidentally, he has complete control. Defendant's contention that the wife owned one-half of the stock when purchased and therefore one-half of the profit from the sales disregards the nature of the marital community and the ownership of its property. Neither the husband nor the wife owns the community property or any specific piece thereof. Each owns in division one-half of all of the property and this ownership must continue until the dissolution of the community by death or divorce. Consequently the wife owns no stock as distinguished from her husband nor any profits from stock transactions. Such profits as accrue must necessarily fall into the marital community of which the defendant is one-half owner."

The analogy between the *Jefferson Lake* case and the instant one is striking. In each case, the defendant owned an indivisible interest in all of the partnership or community property. In each case the defendant had "knowledge" of the purchases and sales.

In the instant case, the short-swing transactions of the Tide Water *Preferred* stock were effected by Lehman Brothers between *December 8, 1954, and March 8, 1955* (Defts.' Ex. E; R. 126a, 168a). Respondent, Thomas, testified that he was informed of the proposed purchases and sales by his firm of Tide Water's *Preferred* stock at the time Lehman Brothers first commenced purchasing Tide Water *common* stock, i. e., about October 8, 1954, *two months before the short-swing transactions actually occurred* (R. 48a, 49a).

It is thus evident that the element of "knowledge," which the Court found lacking in the *Rattner* case, is present in the instant case and requires holding the partner-director, Thomas, liable for the *entire* short-swing profits realized by his firm.

In the *Rattner* case, the Court further said (pp. 565-566) that its conclusion to hold the partner-director liable "for only his proportionate share of the firm's profits finds further support in Rule X-16A-3(b) of the Securities and Exchange Commission which permits a partner to file a report 'only as to that amount of such equity security which represents *his proportionate interest* in the partnership.'"

Following the decision in the *Rattner* case, and concededly as a direct result thereof, the Securities and Exchange Commission, under Release No. 4718, dated June 18, 1952, "proposed that Rule X-16A-3 be amended to require any person who is a member of a partnership which owns securities of an insuer of which he is an officer, director or ten per cent stockholder to report the *entire amount* of such securities."

Rule X-16A-3(b) which was adopted by the Commission shortly thereafter provides that "A partner who is required under Section 240.16a-1 to report in respect of any equity security owned by the partnership shall include in his report the *entire amount* of such equity security owned by the partnership."[18]

In view of the aforesaid amendment of the SEC rule the stated rationale of the Court's opinion in the *Rattner* case is no longer applicable and must be re-evaluated. Since the SEC rule was deemed a valid reason advanced by the Court to *limit* the liability of the partner-director —the amendment of such SEC rule would seem to require the *broadening* of such liability to require the recovery of the "*entire*" partnership profits from such partner-director.

It is basic partnership law that each partner has an indivisible interest in the partnership property and funds. To limit recovery under Section 16(b) to the partner-director's proportionate partnership interest is to ignore the basic public policy of the statute.

In line with the express purpose of the statute, the Courts have extended the literal wording of Section 16(b) to encompass a multitude of other situations which might possibly lead to the evils which Congress sought to eradicate.

It is only by holding the partner-director liable for the *entire* short-swing profits realized by his firm that an effective prophylactic to the stated statutory policy can be fully enforced. The limitation of a partner-director's liability would open the door to wholesale evasion of the Act. Misuse of inside information by director-partner would redound to the advantage of the partnership firm, the members of which would undoubtedly be happy to re-

[18] 17 C. F. R. 240, 16a-3(b); Append. p. 53.

imburse the partner-director for his "proportionate" loss of partnership profits in return for his invaluable "inside tips."

In the *Rattner* case, *supra* (p. 565), the Court refused to conjecture "Whether the result might be different had he (the partner-director) caused the firm to make them (the short-swing purchases and sales)."

The evidence in the record abundantly demonstrates that the inside information concerning Tide Water's affairs which Mr. Thomas imparted to his partners was the cornerstone of his firm's ultimate decision to effect the short-swing transactions in that company's stock.

Such disclosures prompted Lehman Brothers to consummate the Tide Water stock transactions. Accordingly, it can truly be said that Mr. Thomas "caused" these transactions to be entered into by his firm as though he had personally given the orders therefor.

IV.

The recovery should include interest from the date the respondents realized such short-swing profits.

In awarding the limited judgment against respondent, Thomas, the Court below refused to allow any interest whatsoever upon the recovery although it recognized that the purpose of Section 16(b) is "to squeeze all possible profits" and "every possible penny of profit out of such transactions."[16]

In thus failing to grant any interest upon the short-swing profits recovered, the Court in effect *reduced* such

[16] *Smolowe v. Delendo Corp., supra*, p. 239; *Blau v. Lehman, supra*, p. 791.

recovery by an amount equal to the interest earned by the respondents' use of the money from the date the profits were recoverable.

Although the statute is silent with respect to interest, the Courts have on all prior occasions awarded such interest as an incident of the recovery so as to carry out fully the legislative purpose inherent in the statute.[17]

Judge Clark, in his dissenting opinion, expressly noted that "The final anomaly in our exceptional treatment of this case is the denial of all interest for the use of the sums found due to the corporations, contrary to our uniform practice in other cases."[18]

The complete fulfillment of the legislative purpose, which seeks to deter any "insider" from engaging in transactions prohibited by the statute, can only be effected by the removal of all economic benefits which may accrue therefrom. Unless such "insider" is charged with interest for the use of the monies to which he is not entitled, his statutory transgressions will be placed at a premium.

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[17] *Park & Tilford, Inc., v. Schulte* (C. A. 2), 160 F. 2d 984; *Blau v. Mission Corp.* (C. A. 2), 212 F. 2d 77; *Magida v. Continental Can Co.* (C. A. 2), 231 F. 2d 843; *Stella v. Graham Paige Motors Corp.* (C. A. 2), 232 F. 2d 299, 302, Note 4; *Adler v. Klawans* (C. A. 2), 267 F. 2d 840; *Consolidated Engineering Corp. v. Nesbit* (DCSD Calif.), 102 F. Supp. 112.

[18] *Blau v. Lehman, supra*, p. 797.

CONCLUSION.

The judgment dismissing the complaint as against respondents, Lehman Brothers, should be reversed; so much of the judgment which *limited* the recovery as against respondent, Joseph A. Thomas, should be reversed. Judgment should be entered against both respondents, Lehman Brothers and Joseph A. Thomas, jointly and severally, in the sum of $98,686.77, together with interest, costs and disbursements.

Respectfully submitted,

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APPENDIX.

Sections 16(a) and 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sections 78p(a) and 78p(b), provide as follows:

"(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security)

within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Section 3(a) (13) of the Securities Exchange Act of 1934, 15 USCA Section 78c (a) (13), defines "Buy" and "Purchase" as follows:

> "The terms 'buy' and 'purchase' each include any contract to buy, purchase, *or otherwise acquire.*" (Italics supplied.)

Securities and Exchange Rule X-16A-3(b), 17 CFR 240.16a-3(b), as amended, provides as follows:

> "A partner who is required under Sect. 240.16a-1 to report in respect of any equity security owned by the partnership shall include in his report the entire amount of such equity security owned by the partnership. He may if he so elects, disclose the extent of his interest in the partnership and the partnership transactions."